***United States Court of Appeals***

***for the Second Circuit***


# BRIEF FOR APPELLANT

# 74-1511

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IN THE

## United States Court of Appeals

FOR THE SECOND CIRCUIT

SECURITIES INVESTOR PROTECTION CORPORATION,
*Plaintiff-Appellant,*

*against*

CHARISMA SECURITIES CORPORATION,
*Defendant.*

EDWIN L. GASPERINI,
*Petitioner-Appellant,*

GASPERINI & SAVAGE,
*Petitioner-Appellant.*

APPEAL FROM ORDER OF THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
(D. C. Civil Action No. 72 Civ. 981 (M.P.))

# BRIEF OF APPELLANT SECURITIES INVESTOR PROTECTION CORPORATION


THEODORE H. FOCHT
*General Counsel*

WILFRED R. CARON
*Associate General Counsel*

Securities Investor Protection Corporation
900 Seventeenth Street, N.W., Suite 800
Washington, D. C. 20006 (202) 223-8400

*Of Counsel:*

MICHAEL E. DON
*Senior Staff Attorney*

ROBERT G. RICHARDSON
*Attorney*

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## BRIEF OF APPELLANT SECURITIES INVESTOR PROTECTION CORPORATION

### Preliminary Statement

This is a proceeding for the liquidation of the business of Charisma Securities Corporation ("Charisma") under the Securities Investor Protection Act of 1970 ("1970 Act"). The Securities Investor Protection Corporation ("SIPC"), Edwin L. Gasperini as trustee for Charisma and Gasperini

& Savage, the trustee's counsel, join in an appeal from an order of the District Court, Southern District of New York (Pollack, D.J.) (reported at 371 F. Supp. 894) awarding final allowances of compensation to the trustee and his counsel in amounts substantially less than requested by them. The trustee is a partner in the firm of Gasperini & Savage, his counsel. The trustee and counsel requested an aggregate of $30,000, representing a mixed hourly rate of $54.14 for partners and associates. Their fees were to be paid in their entirety from SIPC's funds and SIPC supported their application. Notwithstanding, the District Court awarded an aggregate of only $10,000 representing one-third of the fees requested or a mixed hourly rate of $18.05.

## Statement of the Issues Presented for Review

1. Whether the District Court exceeded its authority or abused its discretion by awarding fees in amounts drastically reduced from the amounts requested by the trustee and his counsel where

(a) All fees will be paid by SIPC by reason of the practical nonexistence of assets in the Charisma estate, and therefore the award of fees in any amount will have no adverse effect on creditors;

(b) SIPC worked closely with the trustee and his counsel, was thoroughly conversant with the nature and scope of their services, and evaluated such services after examination of their time records and fee applications;

(c) SIPC determined that reasonable compensation for all services would be $30,000 and so advised the trustee and his counsel;

(d) The trustee and his counsel acceded to SIPC's view and reduced their requests from the aggregate

sum originally requested in their petitions, namely, approximately $38,000; and

(e) The modified amounts ultimately requested by the trustee and his counsel, and supported by SIPC, were reasonable, and in any event not clearly so excessive as to warrant reduction by the Court.

2. Whether an appeal from a district court's order awarding final compensation to a trustee and his counsel, in a proceeding under the 1970 Act, may be taken as of right or only by permission of the Court of Appeals.

## Statement of the Case

### Introduction

While this Court has had several opportunities to consider the 1970 Act [see *SIPC* v. *Packer, Wilbur & Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 94,583 (2d Cir. 1974); *SEC* v. *F.O. Baroff Co., Inc.*, CCH Fed. Sec. L. Rep. ¶ 94,576 (2d Cir. 1974); *SEC* v. *Alan F. Hughes, Inc.*, 481 F.2d 401 (2d Cir.), *cert. denied*, 414 U.S. 1092 (1973); *SEC* v. *Alan F. Hughes, Inc.*, 461 F.2d 974 (2d Cir.) (1972)], the issues presented on this appeal make appropriate a brief preliminary discussion of certain provisions of the 1970 Act.

Under the 1970 Act SIPC is obliged to create and maintain a fund ("SIPC Fund") primarily through assessments upon its members [§ 78ddd(a) and (c)].[1] The principal purpose of the SIPC Fund is to satisfy promptly claims of customers of failed broker-dealers and to complete certain open contractual commitments, as defined in the 1970 Act [§ 78fff(f)]. In addition, SIPC is authorized to advance money to pay the administrative expenses of the proceeding [§§ 78ccc(b), fff(c)(2)(B) and fff(f)(2)].

1. All 1970 Act citations are to sections of Title 15 of the United States Code.

Although section 78fff(c)(2)(B)(ii) gives SIPC the right to recoup such advances from the debtor's estate, that right has only theoretical significance in cases like Charisma. The liquidation of debtors under the 1970 Act usually involves a substantial call upon the SIPC Fund.

The 1970 Act places the management of SPIC and the SIPC Fund under seven directors. Five are appointed by the President and confirmed by the Senate, one is appointed by the Secretary of the Treasury, and one is appointed by the Federal Reserve Board [§ 78ccc(c)]. In addition to SIPC's own supervision, the distribution of SIPC's funds in a liquidation proceeding is placed in the care of the trustee (and the court), as is the responsibility for determining the validity of claims filed by customers and others. As a result, the 1970 Act requires a district court to appoint as trustee and counsel "such persons as SIPC shall specify", provided they are "disinterested" within the meaning of section 158 of the Bankruptcy Act [§ 78eee(b)(3)]. Similarly, in another major departure from the Bankruptcy Act Congress gave SIPC, rather than the courts, the authority to approve the trustee's hiring and compensation of all persons he deems necessary for the purposes of the liquidation proceeding [§ 78fff(b)(1)(A)].

Section 78fff(c)(1) provides in part that a liquidation proceeding under the 1970 Act is to be governed by the provisions of Chapter X of the Bankruptcy Act and certain provisions of Chapters I through VII thereof, except where the Bankruptcy Act provisions are inconsistent with the 1970 Act, and except that no reorganization is permitted. As a result, section 241 of the Bankruptcy Act supplies the statutory authority for fixing the compensation of the trustee and his counsel.

As indicated by the provisions summarized above, the Congress clearly intended to provide SIPC with broad discretion in matters which affect the disbursement of money from the SIPC Fund.

**Nature of Case, Proceeding and Disposition Below**

The proceeding below was commenced by SIPC on March 8, 1972. The trustee and his counsel effectively carried out their duties and the trustee's final report and account was approved on January 9, 1974. However, the court reserved decision as to their compensation. By order dated February 26, 1974, the District Court denied the applications for compensation submitted by the trustee and his counsel and awarded significantly lesser fees (6a).

Unable to rely on any precedent as to the proper procedure for taking this appeal, the trustee, his counsel and SIPC filed notices of appeal (3a, 5a) pursuant to section 24 of the Bankruptcy Act [11 U.S.C. §47], and applications for leave to appeal as provided in section 250 of the Bankruptcy Act [11 U.S.C. §650] and Rule 6 of the Federal Rules of Appellate Procedure. On April 19, 1974, this Court granted leave to appeal to all appellants. By stipulation the appeals were consolidated.

**Statement of Relevant Facts**

The brief filed herein by the trustee and his counsel amply sets forth the facts involved in this appeal. Rather than burden the Court with a repetitious presentation, SIPC will limit its statement of facts to those matters which it believes warrant emphasis.

Perhaps most importantly it must be stressed that this is a no-asset case for all practical purposes.[2] The satisfaction of customers' claims was accomplished through the SIPC Fund. The administrative expenses have been paid by SIPC. There are no assets from which general creditors may receive dividends. Thus, the size of the final fees granted can have no impact at all on the estate or on any of its creditors other than SIPC.

The trustee and his counsel had originally petitioned for final fees in the aggregate amount of approximately $38,000. After consultation with SIPC the request was reduced by approximately 22 percent to an aggregate of $30,000 (87a, 119a, 123a-125a, 130a-131a, 136a-137a). The District Court cut two-thirds from that amount. Over the period of approximately one and three-quarters years during which this proceeding was pending, the trustee expended a total of 77.7 hours and his counsel a total of 476.4 hours in the discharge of their duties.

Having performed an independent review of the fee applications and the detailed time records kept by both trustee and counsel, SIPC supported the applications as reduced after consultation with SIPC. There was no opposition to those applications.

**Decision and Opinion Below**

The District Court drastically curtailed compensation to the trustee and his counsel. The award ($3,500 to the trustee and $6,500 to his counsel) resulted in effective hourly

2. For purposes of this brief, the term "no-asset case" is intended to include cases in which there are (i) no estate assets or (ii) assets in an amount clearly less than the most conservative estimate of reasonable compensation for the trustee and his counsel. In this case the trustee marshalled aggregate assets of approximately $1,300 which, in any event, was substantially less than administrative expenses other than compensation for the trustee and his counsel.

rates of $45.05 for the trustee and $13.64 for his counsel, or an aggregate mean hourly rate for both of $18.05.

The Court did not disclose the manner in which it determined the trustee's and his counsel's respective shares of the $10,000 awarded. It did not dispute the amount of time the trustee and counsel reported they expended, nor did it find disproportionate the distribution of legal services between partners (25 percent) and associates (75 percent) of the trustee's law firm. The Court did not find that the effective hourly rates resulting from the modified fee applications were unreasonable. Nor did it find that the fees ultimately requested were based on rates usually charged to a private client, obviously not the case in light of the modification of the application and the rates reflected thereby. The Court did state that the trustee and his counsel were ". . . *attempting* to bill their time at the 'going rates' for law firms in New York" (emphasis added), but that observation did not refer to the application as finally submitted to the Court.

With all due respect for the District Court it appears that it reached a clearly erroneous result because of various misapprehensions of law and fact. Among them were the failure to appreciate the complexities of even a relatively small liquidation under the 1970 Act; the misapplication of standards and criteria which are useful and necessary in Chapter X reorganizations but which have no proper place in a no-asset case under the 1970 Act; the erroneous assumption of authority to protect and manage the SIPC fund; and a misconception of the duties and responsibilities of the trustee and his counsel as well as SIPC's role throughout this proceeding—including SIPC's responsible review and the resulting modification of the fee applications.

## POINT I

**Under the circumstances of this case the District Court exceeded its authority or abused its discretion by denying the fees actually requested by the trustee and his counsel and supported by SIPC, which were payable entirely from the SIPC fund.**

The issue in this case is novel and important. Many cases arising under the 1970 Act are no-asset cases. In those cases, as here, it is SIPC which must bear the expense of most if not all of the costs of the proceeding. In those cases, as here, the fees allowed to trustees and their counsel are of no practical concern to a debtor's creditors, but they are of great concern to SIPC which is charged with the responsibility of interesting qualified persons in serving as trustee and counsel. The proper discharge of that responsibility depends largely upon the reasonable expectations of those persons in the area of compensation. As one court has properly observed: "Given the statutory frame-work and the purposes of the [1970] Act, it cannot operate as intended unless trustees and their counsel are adequately compensated for work necessarily done in an efficient manner." *SEC* v. *Glendale Securities Corp.*, 73-C-756 (E.D.N.Y., filed Jan. 14, 1974) at 3. Referring to the District Court's earlier denial of interim compensation in this case [*SEC* v. *Charisma Securities Corp.*, 352 F. Supp. 302 (S.D.N.Y. 1972)], one commentator has stated: "This decision may well prevent SIPC from continuing its policy of appointing an attorney as a trustee and his law firm as his attorney. Indeed, it may prove difficult to hire competent lawyers as SIPC trustees." Note, *The Securities Investor Protection Act of 1970: An Early Assessment*, 73 COLUM. L. REV. 802, 814 (1973).

Only sound and compelling reasons of law or public policy should be permitted to stand in the way of adequate

compensation for trustees and their counsel. For the reasons hereinafter respectfully submitted, SIPC contends that in a no-asset case there are no overriding considerations to warrant a rule which would authorize the courts to deny compensation which SIPC believes is reasonable and appropriate except in most unlikely and exceptional circumstances involving the integrity of the judicial system (discussed below). Whatever might be the economical considerations in a Chapter X reorganization or ordinary bankruptcy, or for that matter in a 1970 Act *asset* case, they are irrelevant in circumstances such as here exist.

**Complexity of the 1970 Act**

This Court long ago observed: "Probably no branch of bankruptcy administration presents more troublesome questions of law and administration than does the insolvency of a stock brokerage or investment concern. In re Wilson (D.C.) 252 Fed. 631, and In re Toole & Henry (C.C.A.) 274 Fed. 337, 24 A.L.R. 470, are only two out of many cases which are illustrative of the complexities of such bankruptcies". *In re Slattery & Co., Inc.*, 294 Fed. 624, 626 (2d Cir. 1923). Those complexities have been greatly increased by the 1970 Act. A district judge from this Circuit, Hon. Kevin Thomas Duffy [formerly New York Regional Administrator for the Securities & Exchange Commission ("SEC")], has appropriately commented:

> "If anything, time has only increased those difficulties. And the engrafting of the SIPC legislation onto the Bankruptcy Act has only compounded the confusion." Duffy, "Reforming SIPC", 7 THE REVIEW OF SECURITIES LEGISLATION, 985, 990 (1974).

The Court of Appeals for the Third Circuit has stated:

> "The intent of Congress to protect customers of financially distressed security dealers is clear, but the specifics of precise resolution of individual situations are clouded by the provisions of a statute which range far from the clarity of blue sky one might expect in this area of law." *SEC* v. *Aberdeen Securities Co., Inc.*, 480 F.2d 1121, 1123 (3d Cir.), *cert. denied*, 414 U.S. 1111 (1973).

Finally a preeminent Bankruptcy Judge (Asa S. Herzog), in making awards of interim compensation, took into account "... the general difficulty in interpreting a highly technical and often inconsistent statute [1970 Act], with a paucity of decisional law establishing guidelines." *SEC* v. *Horizon Securities*, 72 Civ. 5112 (S.D.N.Y., filed Nov. 23, 1973); see also *SEC* v. *Glendale Securities Corp., supra*; *SEC* v. *S. J. Salmon & Co., Inc.*, 72 Civ. 560 (S.D.N.Y., filed May 15, 1973).

At the time this brief was written 103 firms had been liquidated or were being liquidated under the 1970 Act. SIPC can confidently advise this Court that the foregoing observations are not overstated. It is impossible to detail the full reach of complexities but they are considerable indeed. SIPC is intimately familiar with the numerous difficulties encountered by trustees and counsel who must deal with the 1970 Act, often for the first time. Indeed, despite its own extensive experience SIPC can assure this Court that the interpretation and application of that statute continues to raise new and difficult legal issues almost daily. In short, there is no simple 1970 Act liquidation. There are only different levels of difficulty. This case was no exception, as the brief of the trustee and his counsel amply demonstrates.

**SIPC's Role in 1970 Act Liquidations**

Contrary to what appears to have been the belief of the Court below, SIPC maintains not only a legal staff but also personnel with considerable accounting and back office brokerage experience. Because of SIPC's obvious responsibilities for the SIPC Fund and the proper interpretation and application of the 1970 Act, its personnel work very closely with trustees, their counsel, accountants and other persons assisting in the liquidation.[3] See Note, *The Securities Investor Protection Act of 1970: An Early Assessment, supra,* at 824-825. It could not be otherwise, and the record here sufficiently shows that this case was no exception (see 80a-84a paragraphs 11, 13, 16 and 17; 55a-56a paragraphs 26 and 27; 136a-141a).

The close liaison between SIPC and a trustee, his counsel and other staff involves the discussion and resolution of a myriad of problems often of a highly technical nature. The process begins at the time of the appointment of the trustee and his counsel, and the engagement of accountants, with their orientation by members of SIPC's staff The known problems of the case are discussed, and various procedures

3. SIPC's "Third Annual Report 1973" states, in part (page 31):
"The Operations and Examination unit provides professional advice and assistance to the trustees and their staffs in the financial and operational aspects of the administration of debtors' estates. Members of the financial staff review proposed distributions to customers and broker-dealers and help resolve problems relating to erroneous claims, contested claims and claims not covered by the Act. . . . Several attorneys joined SIPC during the year to handle the substantial increase in legal work involved in monitoring the cases, assisting the trustees with various questions arising under the Act and the securities laws generally and preparing legal material for litigation in which SIPC had an interest. At the end of December, 1973, the staff numbered 46. Eight were attorneys; 14 had accounting, financial or investigative backgrounds, 11 of whom had had experience in the brokerage industry."

are worked out. The trustee's additional staffing requirements are discussed, as appropriate. As customers' claims are received, not only must the customers' account positions be analyzed by the trustee's accountants but the legal determination must always be made as to whether a customer's claim is for the net equity of his account [§ 78fff(c)(2)(A)(iv)] or for specifically identifiable property [§ 78fff(c)(2)(C)]. Determinations must be made as to whether a claimant is a "customer" within the meaning of the 1970 Act [§78fff(c)(2)(A)(ii)]; whether a particular instrument is a "security" within the meaning of the 1970 Act [§78fff(c)(2)(A)(v)]; whether a customer's claim is valid or fraudulent, correct or erroneous; whether a particular customer is one excluded from protection by the SIPC Fund under section 78fff(f)(1)(C); *et cetera*. As to all such questions, and many more (see *e.g.* Point II below) which can be discerned merely by a reading of section 78fff of the 1970 Act, SIPC plays an extensive consulting and advisory role with the trustee, his counsel and other staff. There are now a number of decisions which illustrate the highly technical and complex questions which can arise, and they are but the tip of the iceberg with which SIPC, trustees and their counsel are familiar. See, *e.g., SIPC* v. *Packer, Wilbur & Co., Inc., supra; SEC* v. *F. O. Baroff Co., Inc., supra; SEC* v. *Aberdeen Securities Co., Inc., supra; SEC* v. *S. J. Salmon & Co., Inc.*, CCH Fed. Sec. L. Rep. ¶94,582 (S.D.N.Y. 1974); *SEC* v. *Teig Ross, Inc.*, No. 4 73 Civ.107 (D. Minn., filed April 1, 1974); *SEC* v. *Aberdeen Securities Co., Inc.*, 371 F. Supp. 1343 (D. Del. 1974); *SEC* v. *Robert E. Wick*, 360 F. Supp. 312 (N.D. Ill. 1973); *SEC* v. *S. J. Salmon & Co., Inc.*, 72 Civ. 560 (S.D.N.Y., filed June 13, 1973).

SIPC's close cooperation with a trustee, his counsel and staff is not limited to the disposition of customers' claims.

It has an obvious interest in the trustee's proper discharge of his responsibility to marshal and collect assets for a debtor's estate, and in that regard to pursue vigorously causes of action which may exist by reason of the wrongdoing of former officers, directors and employees of a debtor. To the extent recoveries can be realized, enhancement of a debtor's estate diminishes the drain on the SIPC fund. Moreover, the pursuit of such wrongdoers in appropriate cases must have a beneficial effect upon the securities industry which redounds to the advantage of public investors. SIPC's attorneys work closely with trustees and their counsel in this area.

SIPC is not suggesting for a moment that this particular case presented the full range of difficulties and complex questions which can arise under the 1970 Act. It is merely attempting to demonstrate, particularly in light of the views expressed by the District Court, that of necessity it has an intimate familiarity with all liquidations conducted under the 1970 Act—a familiarity which bears heavily upon the issue raised by this appeal. In contrast, as is evident in this case, it is impossible for a district judge to be privy to the activities of a trustee and his counsel to the same degree as is SIPC. This was frankly and properly acknowledged by the court in *SEC* v. *Glendale Securities Corp., supra.* Judge John F. Dooling, Jr. said (at page 2):

> "The nature of the case, perhaps of any matter under the statute, is such that the Court is not intimately exposed to the legal problems that administration actually presents and that account for the greatest part of the time expended. Much must be taken on faith, and great reliance must be placed on the views expressed by SIPC and its counsel, and on the presence as a quasi-party of the SEC."[4]

4. The *Glendale* liquidation proceeding differs from the instant case in that SIPC's application had been, pursuant to section 78eee (a)(3)(A), combined with an injunction action brought by the SEC. No such action was brought by the SEC in this case since Charisma had been out of business for ten months.

**SIPC's Role in Fee Applications**

It can hardly be doubted that there is a necessary and proper role which SIPC should play when trustees and their counsel seek allowances of compensation, particularly when it will be paid entirely by SIPC. In determining the nature of that role it seems appropriate to consider the role which the courts have properly accorded to the SEC in Chapter X reorganizations.

The Courts of Appeals have repeatedly recognized that the recommendations of the SEC in Chapter X reorganizations are highly valuable because of its familiarity with the facts and its expertise in that highly specialized area of law. *Surface Transit, Inc.* v. *Saxe, Bacon & O'Shea,* 266 F.2d 862, 865 (2d Cir. 1959); *In re TMT Trailer Ferry, Inc.,* 434 F.2d 804, 807 (5th Cir. 1970); *In re Imperial "400"* NATIONAL, INC., 432 F.2d 232, 240 (3d Cir. 1970); 6A COLLIER ON BANKRUPTCY ¶13.02, at 901 (14th ed. 1972). In *Finn* v. *Childs Co.,* 181 F.2d 431, 438 (2d Cir. 1950) this Court stated:

> "Nevertheless the figures presented by the S.E.C. are not 'mere casual conjectures,' but are 'recommendations based on closer study than a district judge could ordinarily give to such matters.'"

In *Scribner & Miller* v. *Conway,* 238 F.2d 905, 907 (2d Cir. 1956), this Court recognized the SEC's expertise by holding that such recommendations "should be followed unless the reorganization judge showed reasons otherwise based on specific findings." See also, *In re Polycast Corp.,* 289 F.Supp. 712, 722 (D. Conn. 1968).

In 1970 Act liquidations not only is SIPC intimately familiar with many of the details of the case, indeed more so than is the SEC in Chapter X proceedings, but in a no-asset case such as this it is SIPC which pays the bill. As great

weight is given to the recommendations of the SEC because they represent "the expert opinion of a disinterested agency" (*Finn* v. *Childs Co., supra,* at 438), even greater weight should be given to SIPC's recommendation by reason of its responsibility for the management and disbursal of its own funds. In SIPC's view this case is a good illustration of how seriously SIPC takes its responsibility. As the record shows it caused a 22 percent reduction in the fee requests of the trustee and his counsel. It has never failed to express disagreement with trustees or their counsel on matters of fees when such disagreement seemed appropriate. See, *e.g., SEC* v. *Glendale Securities Corporation, supra; SEC* v. *F.O. Baroff Co., Inc.,* 72 Civ. 60 (S.D.N.Y. filed March 6, 1974) (Report of Bankruptcy Judge Edward J. Ryan, as Special Master).

**Application of Section 241 In Chapter X Proceedings**

Section 241 of the Bankruptcy Act [11 U.S.C. § 641] authorizes a District Judge to allow reasonable compensation to trustees and their counsel in corporate reorganizations. It evolved nearly intact from sections 77B(c)(9) and (11) of the Bankruptcy Act of 1898.

Congressional concern for protecting the interests of creditors by reducing the cost of reorganization has been cited repeatedly by the courts as motivating the passage of section 77B. *Brown* v. *Gerdes,* 321 U.S. 178, 181-182 (1944); *Dickinson Industrial Site Inc.* v. *Cowan,* 309 U.S. 382, 388 (1940); *Finn* v. *Childs Co., supra; In re Standard Gas and Electric Co.,* 106 F.2d 215, 216 (3d Cir. 1939); 6A COLLIER ON BANKRUPTCY, ¶13.01, at 887 (14th ed. 1972). Judicial control of compensation was necessary to protect the estate for creditors. *Dickinson Industrial Site* v.

*Cowan, supra; Brown* v. *Gerdes, supra;* 6A COLLIER ON BANKRUPTCY, *supra,* at 887. Chapter X of the Bankruptcy Act was enacted to provide a vehicle for the rehabilitation of financially distressed corporations and to that end economy is essential. *London* v. *Snyder,* 163 F.2d 621, 625 (8th Cir. 1947); *Butzel* v. *Webster Apartments Co.,* 112 F.2d 362, 367 (6th Cir. 1940); 6A COLLIER ON BANKRUPTCY, ¶13.02, at 911, 912. Any depletion of the assets is critical, and non-essential expenditures could have a devastatingly adverse effect on the feasibility of a reorganization plan. *Brown* v. *Gerdes, supra,* at 498; *Finn* v. *Childs Co., supra,* at 435. Consequently, associated with the Court's approval of a plan of reorganization is close scrutiny of compensation requests.

In light of its responsibility to creditors and the emerging reorganized corporation, the courts have properly adopted the view that in fixing fees they must "strike a reasonable mean between the two extremes of free choice and forced economy", an approach heavily relied upon by the District Court. In addition to that responsibility, the courts have recognized that by enacting section 241 Congress meant to end. ". . . the spectacle of fiduciaries fixing the worth of their own services and exacting fees which often had no relation to the value of the services rendered." *Leiman* v. *Guttman,* 336 U.S. 1, 7 (1949). In short, there are two policies underlying section 241 which were intended to guide the courts in reviewing fees requested by trustees and their counsel, namely:

> (1) Protection of the rightful interests of creditors and the reorganized corporation;
>
> (2) Protection of the judicial system against abuse.

Both are essential in Chapter X proceedings. Only the second applies in 1970 Act no-asset cases.

**Application of Section 241 in 1970 Act No-Asset Cases**

As noted earlier (p. 4) section 78fff(c)(1) of the 1970 Act makes section 241 of the Bankruptcy Act applicable in 1970 Act liquidations. The manner in which section 78fff(c)(1) makes certain sections of the Bankruptcy Act applicable is imprecise and fraught with difficulty.[5] See 3 COLLIER ON BANKRUPTCY, ¶60.86, at 1251 (14th ed. 1974); Point II *infra*. However, it does specifically qualify the incorporation of Bankruptcy Act provisions by stating that they shall apply "except as inconsistent with the provisions of this Act. . . ." In other words, section 241 must be made to work for the 1970 Act in a manner consistent with its needs. It should perhaps be emphasized that section 241, although intended to effectuate a policy of reasonable economy, does not by its terms prescribe the principles or guidelines by which that objective was to be reached. It left that matter for the courts, and hence the guides established by the courts represent their considered view of what is appropriate for a corporate reorganization. Obviously they were not called upon to decide what is reasonable in

5. Section 78fff(c)(1) provides, in pertinent part:
"Except as inconsistent with the provisions of this Act and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of chapter X and such of the provisions (other than section 90e [sic] of Title 11) of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court had been entered directing that bankrupty be proceeded with pursuant to the provisions of such chapters I to VII, inclusive. . . ."

a no-asset case where compensation will be paid from a source other than the estate in reorganization.

It seems self-evident that in a 1970 Act no-asset case awards of compensation should not be governed by Chapter X principles which depend for their applicability upon a genuine need to protect creditors and the reorganized corporation. In such no-asset cases it is inappropriate to apply the Chapter X view, evolved by the courts for reorganizations, that one must "strike a reasonable mean between the two extremes of free choice and forced economy". Equally inappropriate is the arbitrary invocation of standards, perfectly valid in Chapter X reorganizations, such as fees "must bear a sensible and practical relationship to the size of the estate", "the value of the estate is a highly significant factor to be appreciated", there must be "consideration of the burden that the estate can bear", and that the court must be concerned with "the stricken entity". All these phrases were used by the District Court in its opinion below or its prior opinion in which it denied interim allowances (352 F.Supp 302). The recurrence of the theme is sure evidence that the Court felt compelled to impose inappropriate economies.

In a no-asset case wherein SIPC will pay all fees, the amount of compensation to be paid to a trustee and his counsel clearly is not subject to the rules of economy evolved in Chapter X proceedings. The matter should really come down to fair compensation for services rendered, and it seems to SIPC that it is in the best position to determine what is fair. The Court has no responsibility to creditors which could justify the substitution of its judgment for that of SIPC.

It has already been observed that section 241 was designed in part to prevent the use of the judicial system

as a vehicle for the payment of outrageous or unconscionable fees. That policy which was designed to protect the integrity of the judiciary is, of course, fully viable in any 1970 Act proceeding, including no-asset cases. SIPC does not at all suggest that in a no-asset case the Court should always award what SIPC is willing to pay, regardless of amount. Quite the contrary! SIPC certainly recognizes that no one can be permitted to make a mockery of the courts. It does contend, however:

> A. In a no-asset case a district court should allow fees to trustees and their counsel in amounts supported by SIPC if they are within a broad range of what is reasonable, even though reasonable men may differ within that range,
>
> B. The zone of reasonableness should be deemed exceeded only when fees requested and supported by SIPC can properly be classified as so excessive or outrageous as to call for the intervention of the court in order to protect the integrity of the judicial system.

These standards would recognize the court's duty to itself and SIPC's proper role. They would not arbitrarily impose Chapter X standards of economy which are premised upon considerations wholly irrelevant in 1970 Act no-asset cases. Neither creditors nor the courts would be adversely affected by the adoption of such criteria.

The standards urged by SIPC would not affect the court's traditional powers to deal with such matters as a trustee's misfeasance in office, gross dereliction and the like. In the event that should ever occur, appropriate remedies should surely be invoked by the courts and vigorously supported by SIPC. Other instances may arise which may require some abridgement of that standard. Solutions for special

cases will have to await the event. Similarly, the applicable rules for cases in which creditors' interests require protection need not be formulated here.

**Reasonableness of Fees Supported By SIPC In this Case**

The brief of the trustee and his counsel demonstrates that the fees requested and supported by SIPC are reasonable, or at the very least fall within a broad range of reasonableness. SIPC will therefore limit its discussion of the reasonableness of those fees to certain factors it considered.

This Court has recently emphasized that fixing a reasonable hourly rate for time actually expended "is the only legitimate starting point for analysis." *City of Detroit* v. *Grinnell,* 73-1211, 73-1420 (2d Cir., filed Mar. 13, 1974). SIPC unlike the District Court, carefully reviewed the time records supplied by the trustee and his counsel (137a, 141a) and evaluated the time expended in light of its familiarity with this proceeding, the efforts of the trustee and his counsel, and the results achieved. Of course, evaluation of the time spent is of paramount importance as the courts have recognized. *In re Hudson & Manhattan Railroad Co.,* 339 F.2d 114 (2d Cir. 1964); *In re Paramount Merrick, Inc.,* 252 F.2d 482 (2d Cir. 1958); *Levin* v. *Barker,* 122 F.2d 969 (8th Cir. 1941), *cert. denied,* 315 U.S. 813 (1942); 3A COLLIER ON BANKRUPTCY, ¶ 62.12, at 1491 (14th ed. 1972).

In evaluating the services rendered in this case, SIPC also took into account the "ability and experience" of the trustee and his counsel [see *Jacobowitz* v. *Double Seven Corp.,* 378 F.2d 405, 408 (9th Cir. 1967)], and it especially noted the trustee's expeditious disposition of 80 percent of the claims within six weeks. Those results, notwithstand-

ing the relatively small number of claims, represented an exemplary compliance with the mandate of section 78fff(a)(1)(B) which looks to the prompt satisfaction of claims of customers. Under all the circumstances SIPC was of the opinion that $30,000 aggregate compensation would be fair and reasonable, and once it communicated that view the trustee and his counsel commendably reduced their applications accordingly. SIPC's judgment was also based on prior experience in other liquidation proceedings.

It is possible that the fees supported by SIPC might seem high to one who has not had the experience of conducting a 1970 Act liquidation proceeding. In point of fact even small cases, given the inherent complexity already noted, have a tendency to be costly. This seems to have been appreciated by Judge Dooling in *SEC* v. *Glendale Securities Corp., supra.*

The District Court stated its belief that "going rates" should be inapplicable. Of course the fees finally requested here did not reflect the "going rates" of the trustee and his counsel. Consequently any discussion of "going rates" would raise hypothetical questions which courts traditionally refuse to decide. But it seems appropriate to call into question the view of the District Court. It seems to SIPC that in a no-asset case, for all the reasons already stated, there is no special reason to bar absolutely the application of normal hourly rates in all cases under all circumstances.

**Errors Of The Court Below**

The District Court committed certain legal and factual errors. This brief has already dealt with its erroneous reliance on inapplicable Chapter X criteria, its mistaken belief that SIPC "rubberstamped" these fees, and its sim-

plistic view of 1970 Act proceedings, including this one. In light of the contents of SIPC's application for leave to appeal, as well as the brief of the trustee and his counsel, discussion of other errors will be limited.

When the District Court denied interim compensation in this case it acknowledged: "The function of SIPC is to administer this fund...." *SEC* v. *Charisma Securities Corp., supra,* at 306. Yet in making the final award it appears to have assumed broad power to supervise SIPC's management of the SIPC Fund. To the extent the Court might have assumed that authority for purposes of the issue before it, it committed plain error. As noted at the outset of this brief (p. 4), the 1970 Act places the responsibility for the care and management of the SIPC Fund in its Board of Directors and personnel. Further argument on the point seems unnecessary.

The District Court referred to a letter it requested from SIPC's General Counsel, and commented that it "... wholly fails to indicate that SIPC even saw the claims, the files, or anything to do with them except the trustee's report and perhaps some oral explanations thereof." In point of fact that letter (139a-141a), as its first sentence states, was a response to the Court's request for a description of the services required of the trustee and his counsel, not a description of SIPC's extensive participation.

The District Court failed to review the time records of the trustee and his counsel, although when it decided the application for interim fees it recognized the importance of such records and directed compliance with this Court's holding in *In re Borgenicht,* 470 F.2d 283 (2d Cir. 1972) [cited as *Borgenicht* v. *Hahn, Hessen, Margolis & Ryan* by the District Court]. The District Court's failure to review such records was error which undoubtedly contributed to its misapprehensions of the services of the trustee and his counsel.

Except for a few disputed claims the District Court expressed its view that the satisfaction of the claims of customers entailed no more than an accounting function. That view was clearly erroneous. Previous discussion in this brief makes it very clear that even in the absence of disputes the determination of a customer's rights under the 1970 Act involves the interpretation and application of its terms. Although the services of accountants are undoubtedly necessary to that process, in the final analysis there is an obvious need for the exercise of legal judgment.

The District Court criticized SIPC's statutory responsibility to designate trustees and their counsel for appointment by the Court, and it urged legislative and operational changes. The possibility exists that the Court's disaffection with this aspect of the 1970 Act influenced its decision to award total fees of $10,000 which reflected a mixed hourly rate of $18.05[6] if that was the case then the Court erred since SIPC's authority to designate trustees and their counsel has been upheld by this Court in *SIPC* v. *Oxford Securities, Ltd.*, 486 F.2d 1396 (2d Cir. 1973).[7]

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6. In connection with the District Court's denial of interim compensation in this case, one commentator has noted: "A third judge of the Southern District of New York found a more subtle way to exercise control over SIPC's choice of trustees." Note, *The Securities Investor Protection Act of 1970: An Early Assessment, supra* at 813. This statement was made in the course of a discussion of some judicial reactions to the authority which the 1970 Act confers upon SIPC to designate trustees and their counsel, including the decision of the District Court in the *Oxford Securities, Ltd.* case cited above in the text.

7. The absence of an opinion has led some members of the Bench and Bar to question the precise nature of the Court's holding in the *Oxford Securities, Ltd.* case. See Guttman, *"Broker-Dealer Bankruptcies"*, 48 N.Y.U.L. Rev. 887, 934-936 (1973).

**The Fees Supported By SIPC Should Be Awarded By This Court**

Judicial discretion is difficult to delimit but the courts have generally recognized that abuse occurs if the wrong legal standards are used or the court proceeds upon an erroneous application of the law. *Massachusetts Mutual Life Insurance Co.* v. *Brock,* 405 F.2d, 429, 432 (5th Cir. 1968); *In re Albert Dickinson Co.,* 104 F.2d 771, 775 (7th Cir. 1939); *Stein* v. *Hemker,* 157 F.2d 740, 743 (8th Cir. 1946); 6A COLLIER ON BANKRUPTCY, ¶ 13.02, at 904.

SIPC submits that the court below abused its discretion as a result of serious errors of law and fact. Its order should be reversed, and the fees supported by SIPC should be awarded by this Court to the trustee and his counsel.

## POINT II

**An appeal from a final order making allowances of compensation to trustees and their counsel in 1970 Act proceedings may be taken of right under Section 24a of the Bankruptcy Act.**

The question of whether a final order setting compensation for trustees and their counsel under the 1970 Act maybe appealed as of right or only by leave of the Court of Appeals is important to the administration of that Act. The present uncertainty is discussed at page 5 of this brief and at pages 2 and 14-15 of SIPC's petition for leave to appeal.

As noted earlier in this brief (p. 4) section 78fff(c)(1) of the 1970 Act incorporates various provisions of Chapters I through VII and Chapter X of the Bankruptcy Act. Commentators have correctly observed that section

78fff(c)(1), despite the apparent specificity of its terms, is somewhat confusing and unclear. 3 COLLIER ON BANKRUTCY, ¶ 60.86, at 1251; Note, *The Securities Investor Protection Act of 1970: An Early Assessment, supra,* at 823-824 (1973). The discussions in the cited materials sufficiently explain the difficulty which is characterized in the second as "the most serious problem facing SIPC trustees and attorneys." Those authors conclude that for all practical purposes section 78fff(c)(1) leaves it to the courts (in the first instance, to trustees, their counsel and SIPC) to determine which provisions of the Bankruptcy Act should apply based upon a utilitarian test. In other words, which provisions are most likely to subserve the ends of a 1970 Act proceeding. Thus it was stated:

> "Where provisions under Chapters X and I to VII overlap, the trustee will, of course, proceed pursuant to the provision most adaptable and appropriate to effectuate the purposes of a SIPC liquidation." 3 COLLIER ON BANKRUPTCY, *supra,* at 1256.

SIPC submits that the foregoing views are appropriately flexible and that they are consistent with the legislative purpose underlying section 78fff(c)(1).

In determining whether appeals lie as of right or by permission only from final orders making awards of compensation, it is necessary to recognize the nature of a 1970 Act proceeding. Although section 78fff(c)(1) makes applicable provisions of Chapter X which are not inconsistent with the 1970 Act, it prohibits reorganization thereby automatically making much of Chapter X inapplicable. Under section 78fff(a) a 1970 Act proceeding is a liquidation proceeding substantially akin to ordinary bankruptcies conducted under Chapters I through VII of the Bankruptcy Act. In a sense it is designed to enforce certain of the

regulatory provisions of the Securities and Exchange Act of 1934 to which the 1970 Act is an amendment [§ 78bbb], as evidenced by some of the grounds upon which a broker-dealer shall be liquidated [§§ 78eee(b)(1)(A)(iv) and (v)] and certain other provisions of the 1970 Act [see *e.g.* §§78fff(h); ggg(d); iii(f); *jjj*(a) and (b); *lll*(2)]. However, once a trustee is appointed the proceeding thereafter is analogous to a stockbroker bankruptcy proceeding under section 60e of the Bankruptcy Act [11 U.S.C. § 96e] on which the protection of the SIPC Fund and certain other changes are superimposed. Perhaps the principal reason for reference to Chapter X procedures is the provision in the 1970 Act which authorizes a trustee to operate a debtor's business in order to complete certain open contractual commitments of the debtor. § 78fff(a)(2); *SEC* v. *Aberdeen Securities Co., Inc.*, 480 F.2d 1121 (3d Cir.), *cert. denied*, 414 U.S. 1111 (1973); S.R. Rep. No. 91-1218, 91st Cong., 2d Sess. 12 (1970). Although a 1970 Act liquidation does not work precisely the same as an ordinary stockbroker bankruptcy, it is a straight liquidation proceeding and clearly not a reorganization proceeding.

In adopting the Chandler Act, Congress determined through section 24a of the Bankruptcy Act that appeals from final orders awarding compensation should be taken as of right in straight bankruptcies unless the amount involved is less than $500. In contrast it decided through section 250 of the Bankruptcy Act that all such appeals should be taken by only permission of the Court of Appeals in reorganization proceedings. The policy underlying the latter choice was the need to expedite the finality of approved plans of reorganization unencumbered by delays resulting from possibly frivolous appeals from compensation awards. See, *e.g. Dickinson Industrial Site* v. *Cowan supra; In re Van Sweringen Corp.*, 180 F.2d 119, 121 (Cir.

1950); *Cohen* v. *Casey,* 152 F.2d 610, 611 (1st Cir. 1945). In a 1970 Act liquidation proceeding, as in ordinary bankruptcy, such considerations do not apply.

It is submitted that the proper implementation of section 78fff(c)(1) leads to the selection of section 24a of the Bankruptcy Act as controlling appeals of this type. Not only would that result be consistent with the 1970 Act, but it would also give effect to the usual rule that final orders are appealable as of right in federal litigation. 28 U.S.C. § 1291. *Cf. SEC* v. *Allan F. Hughes,* 481 F.2d 401 (2d Cir.), *cert. denied,* 414 U.S. 1092 (1973).

## CONCLUSION

**The order of the District Court should be reversed and the application of the trustees and his counsel for final compensation should be granted by this Court.**

Respectfully submitted,

THEODORE H. FOCHT
*General Counsel*

WILFRED R. CARON
*Associate General Counsel*

Securities Investor Protection Corporation
900 Seventeenth Street, N.W., Suite 800
Washington, D.C. 20006 (202) 223-8400

*Of Counsel:*

MICHAEL E. DON
*Senior Staff Attorney*

ROBERT G. RICHARDSON
*Attorney*